

ARIZONA-AMERICAN WATER COMPANY, INC.

DOCKET NO. W-01303A-05-0718

DIRECT TESTIMONY

OF

MARYLEE DIAZ CORTEZ, CPA

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

February 10, 2006

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1 INTRODUCTION

2 Q. Please state your name, occupation, and business address.

3 A. My name is Marylee Diaz Cortez. I am a Certified Public Accountant. I
4 am the Chief of Accounting and Rates for the Residential Utility Consumer
5 Office (RUCO) located at 1110 W. Washington, Phoenix, Arizona 85007.

6
7 Q. Please state your educational background and qualifications in the field of
8 utility regulation.

9 A. Appendix I, which is attached to this testimony, describes my educational
10 background and includes a list of the rate case and regulatory matters in
11 which I have participated.

12
13 Q. Please state the purpose of your testimony.

14 A. The purpose of my testimony is to discuss and provide recommendations
15 regarding Arizona-American Water Company Inc.'s (Company or AZ-AM)
16 request for various approvals of a proposed transaction between the
17 Company and Maricopa County Municipal Water Conservation District
18 (MWD) for the construction of a surface water treatment facility (the White
19 Tanks Project).

20
21 **THE REQUESTED APPROVALS**

22 Q. Specifically, what is AZ-AM asking approval of in its application?

23 A. AZ-AM is seeking Commission approval of the following:

- 1) Preapproval of a capital lease agreement AZ-AM has with the MWD for leased capacity in a water treatment facility that MWD plans to construct.
- 2) A finding that the capital lease with MWD is prudent.
- 3) Authority for AZ-AM to issue indebtedness in an amount equal to the capital lease pursuant to A.R.S. §40-301.
- 4) Authority for AZ-AM to transfer certain assets to the MWD pursuant to A.R.S. §40-285.
- 5) Authority to implement a revised CAP hook-up fee.
- 6) Preapproval of AZ-AM's proposed ratemaking treatment of the capital lease.
- 7) Preapproval of AZ-AM's proposed regulatory process for the capital lease.

Preapproval and Prudency of the Capital Lease

Q. Please discuss the Company's request for Commission preapproval of the capital lease and a finding of prudency.

A. AZ-AM is requesting that the Commission preapprove its capital lease transaction with the MWD and make a finding that the transaction is prudent, prior even to the construction of the related assets.

1 Q. Is it normal ratemaking practice to preapprove utility assets and make a
2 prudency finding prior to those assets even being constructed?

3 A. No. The normal ratemaking practice is for the utility to put assets in
4 service and then file a rate case requesting rate recognition of the assets.
5 This allows the regulator to examine *all* ratemaking elements on a
6 comprehensive basis.

7

8 Q. Is there justification for a departure from the normal ratemaking practice in
9 this instance?

10 A. No. The normal ratemaking practice is sufficient to accommodate this
11 proposed transaction. The Company should simply file a rate application
12 requesting recovery of the cost once the water treatment plant is
13 completed and the lease entered into.

14

15 Q. Does the Commission typically allow rate recognition of plant in service?

16 A. Yes, as long as the plant meets the used and useful principle, is found to
17 be prudent, and is necessary to the provision of service. Thus, normal
18 ratemaking procedures will accomplish the same end result as the
19 Company's request without the need for "preapprovals" or extraordinary
20 ratemaking processes.

21

22

23

1 Q. What is your recommendation regarding the preapproval request?

2 A. RUCO recommends the denial of the preapproval request. The normal
3 ratemaking process is sufficient to accommodate the rate recognition of
4 the proposed water treatment plant.

5

6 **Authority to Issue Indebtedness**

7 Q. Please discuss the Company's request for authority in issue debt.

8 A. Pursuant to ARS § 40-301, public utilities must receive Commission
9 approval to issue debt that is payable over a period that exceeds twelve
10 months. The proposed capital lease is for a period of forty years, and
11 thus, requires Commission approval.

12

13 Q. Does the Commission routinely approve utility financing requests?

14 A. Yes.

15

16 Q. Does Commission approval of a financing request also constitute approval
17 of the rate recovery of the financed assets?

18 A. No. The approval of a financing request merely gives the utility authority
19 to issue debt. The rate recovery of the financed assets is determined in a
20 separate rate proceeding.

21

22 Q. What is your recommendation on this request?

23 A. RUCO recommends approval of the financing request.

Authority to Transfer Assets

Q. Please discuss the Company's request for authority to transfer assets to MWD.

A. Pursuant to ARS § 40-285, public utilities must receive Commission authority in order to sell public utility assets. The capital lease agreement AZ-AM has with MWD involves the sale of land, plant design documents and a pipeline from AZ-AM to MWD, which require approval.

Q. What are the terms of proposed sale of assets?

A. The agreement between AZ-AM and MWD sets the sale price of the 45-acre land site at the lesser of the appraised value, or \$30,000 per acre. AZ-AM believes it will appraise at more than \$30,000 per acre, thus, the sales price will be \$1,350,000. The land site was purchased by AZ-AM in 2002 for \$555,903. The sale price for the plant design and the pipeline will be the reasonable costs incurred by AZ-AM, including internal and overhead costs.

Q. What do you recommend regarding approval of the proposed sale of assets?

A. RUCO recommends Commission approval of the proposed sale of assets. This recommendation, however, is limited solely to the sales transaction and does not extend to the sales price and the ultimate ratemaking treatment of the sales price.

1 Q. Why is the sales price a concern?

2 A. The price AZ-AM sells these assets for will ultimately become part of
3 MWD's cost of building the treatment plant. MWD's cost of building the
4 treatment plant will then form the basis of the capital lease payments and
5 liability, which AZ-AM will seek to recover from ratepayers. The fact that
6 the gain AZ-AM realizes on the sale of the land will become part of the
7 cost of the capital lease that AZ-AM will seek to recover through rates, is
8 an issue that will require examination when the Company files for rate
9 recovery of the lease, and need not be decided as part of a request for
10 authority to sell assets.

11
12 **Revised CAP Hook-up Fee**

13 Q. Please discuss the Company's request for a revised CAP hook-up fee.

14 A. The Company currently has authorized two hook-up fees. One was
15 designed to recover the cost of retaining Agua Fria's CAP allocation (CAP
16 Hook-up Fee). This fee will be fully collected in the second quarter of
17 2006 and will cease. The second hook-up fee is designed to offset the
18 cost of water facilities needed to service growth (Water Facilities Hook-up
19 Fee). The Company proposes to discontinue the Water Facilities Hook-
20 up Fee and continue the CAP Hook-up Fee albeit as a higher fee.

1 Q. What is RUCO's recommendation regarding the revised hook-up fee
2 request?

3 A. RUCO does not object to this request.
4

5 **Preapproval of the Rate Treatment and Rate Process for the Lease**

6 Q. Please discuss the Company's request for preapproval of the rate
7 treatment of the lease and the rate process for the lease.

8 A. The Company has proposed a ratemaking methodology and process for
9 obtaining rate recognition of the lease. It is requesting that this
10 methodology and process receive preapproval in the context of this case.
11

12 Q. Please explain AZ-AM's proposed methodology and process.

13 A. The Company is proposing the following process:

- 14 1) Approve the Company's application in this docket by March 6,
15 2006.
- 16 2) Approve a revised hook-up for Agua Fria no later than second
17 quarter 2006.
- 18 3) AZ-AM will file a rate case in second quarter 2007 based on a 2006
19 test year, for which it requests a Commission Order by second
20 quarter 2008. As part of the 2007 rate case the Commission would
21 create a surcharge mechanism through which the Company could
22 begin recovering of costs of capital lease.

1 4) When the treatment plant is complete, the Company would begin
2 recovery under the surcharge. The Company would be permitted
3 to defer the operating costs of the plant for the first year of
4 operation.

5 5) After the treatment plant has operated for a year, the Company
6 would be permitted to step-up the surcharge to also recover the on-
7 going and deferred operating costs of the treatment plant.

8

9 Q. Please comment on the Company's proposed process.

10 A. The process requested by the Company entails having a rate case prior to
11 completion of the treatment plant, and then allowing step rate increases
12 after the resolution of the rate case in order to incorporate the cost of the
13 treatment plant in rates. RUCO does not support the rate recognition of
14 incremental investment and incremental expenses related to just one
15 element of the Company's revenue requirement outside the context of a
16 full rate case. This results in biased and piecemeal ratemaking.

17

18 Q. Didn't the Commission make an exception to the single-issue/piecemeal
19 ratemaking concern in authorizing certain Arsenic Cost Recovery
20 Mechanisms (ACRM)?

21 A. Yes. An exception was made for arsenic for several specific reasons.
22 The new arsenic standard was a Federal mandate to lower arsenic levels,
23 which was not funded and required compliance by a specific date.

1 Arizona water companies had no flexibility in the timing of compliance or
2 rate case filings, or whether or not to even undertake the projects.
3 Further, since all water companies faced the same deadline, all would
4 have had to file for increased rates at the same time, overloading the
5 Commission's resources. The ACRM was an appropriate remedy for a
6 very unique set of circumstances.

7

8 Q. How does the current situation differ?

9 A. The current situation differs for several reasons. First, the proposed
10 treatment plant is not as a result of a Federal mandate. It is a
11 discretionary decision made by the Company. Second, there is no
12 mandatory compliance date. Thus, the Company can time its rate case to
13 coincide with the completion of the treatment plant. Third, because the
14 treatment plant is not required by Federal mandate for all water
15 companies, its completion will not result in numerous rate case filings that
16 would overwhelm the Commission.

17

18 Q. What process does RUCO recommend?

19 A. RUCO recommends that the Company wait to file a rate case until the
20 new treatment plant is completed. By then, the cost of the capital lease
21 will be known and measurable and base rate treatment of the cost can be
22 determined. This is the normal regulatory process for plant additions and
23 thus is fair and appropriate. Further, because MWD is financing and

1 building the plant, the Company will incur no costs until the plant is in
2 service and lease payments begin. Thus, there is a much shorter lag
3 between the time the Company will begin to pay for the plant and when
4 the plant is included in rates than would be the case if the Company were
5 constructing the plant.

6

7 **CONCLUSION**

8 Q. Please summarize your recommendations.

9 A. RUCO recommends the Commission approval of the following requests:

10 1) Authority to issue long-term indebtedness.

11 2) Authority to sell and transfer certain assets.

12 RUCO does not object to the revised hook-up fee request. RUCO
13 recommends that the remaining requests in this docket be denied. The
14 normal ratemaking process is fully capable of accommodating the
15 proposed capital lease transaction.

16

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APPENDIX I

APPENDIX I

Qualifications of Marylee Diaz Cortez

- EDUCATION:** University of Michigan, Dearborn
B.S.A., Accounting 1989
- CERTIFICATION:** Certified Public Accountant - Michigan
Certified Public Accountant - Arizona
- EXPERIENCE:** Audit Manager
Residential Utility Consumer Office
Phoenix, Arizona 85007
July 1994 - Present

Responsibilities include the audit, review and analysis of public utility companies. Prepare written testimony, schedules, financial statements and spreadsheet models and analyses. Testify and stand cross-examination before Arizona Corporation Commission. Advise and work with outside consultants. Work with attorneys to achieve a coordination between technical issues and policy and legal concerns. Supervise, teach, provide guidance and review the work of subordinate accounting staff.

Senior Rate Analyst
Residential Utility Consumer Office
Phoenix, Arizona 85004
October 1992 - June 1994

Responsibilities included the audit, review and analysis of public utility companies. Prepare written testimony and exhibits. Testify and stand cross-examination before Arizona Corporation Commission. Extensive use of Lotus 123, spreadsheet modeling and financial statement analysis.

Auditor/Regulatory Analyst
Larkin & Associates - Certified Public Accountants
Livonia, Michigan
August 1989 - October 1992

Performed on-site audits and regulatory reviews of public utility companies including gas, electric, telephone, water and sewer throughout the continental United States. Prepared integrated proforma financial statements and rate models for some of the largest public utilities in the United States. Rate models consisted

of anywhere from twenty to one hundred fully integrated schedules. Analyzed financial statements, accounting detail, and identified and developed rate case issues based on this analysis. Prepared written testimony, reports, and briefs. Worked closely with outside legal counsel to achieve coordination of technical accounting issues with policy, procedural and legal concerns. Provided technical assistance to legal counsel at hearings and depositions. Served in a teaching and supervisory capacity to junior members of the firm.

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

<u>Utility Company</u>	<u>Docket No.</u>	<u>Client</u>
Potomac Electric Power Co.	Formal Case No. 889	Peoples Counsel of District of Columbia
Puget Sound Power & Light Co.	Cause No. U-89-2688-T	U.S. Department of Defense - Navy
Northwestern Bell-Minnesota	P-421/EI-89-860	Minnesota Department of Public Service
Florida Power & Light Co.	890319-EI	Florida Office of Public Counsel
Gulf Power Company	890324-EI	Florida Office of Public Counsel
Consumers Power Company	Case No. U-9372	Michigan Coalition Against Unfair Utility Practices
Equitable Gas Company	R-911966	Pennsylvania Public Utilities Commission
Gulf Power Company	891345-EI	Florida Office of Public Counsel

Jersey Central Power & Light	ER881109RJ	New Jersey Department of Public Advocate Division of Rate Counsel
Green Mountain Power Corp.	5428	Vermont Department of Public Service
Systems Energy Resources	ER89-678-000 & EL90-16-000	Mississippi Public Service Commission
El Paso Electric Company	9165	City of El Paso
Long Island Lighting Co.	90-E-1185	New York Consumer Protection Board
Pennsylvania Gas & Water Co.	R-911966	Pennsylvania Office of Consumer Advocate
Southern States Utilities	900329-WS	Florida Office of Public Counsel
Central Vermont Public Service Co.	5491	Vermont Department of Public Service
Detroit Edison Company	Case No. U-9499	City of Novi
Systems Energy Resources	FA-89-28-000	Mississippi Public Service Commission
Green Mountain Power Corp.	5532	Vermont Department of Public Service
United Cities Gas Company	176-717-U	Kansas Corporation Commission

General Development Utilities	911030-WS & 911067-WS	Florida Office of Public Counsel
Hawaiian Electric Company	6998	U.S. Department of Defense - Navy
Indiana Gas Company	Cause No. 39353	Indiana Office of Consumer Counselor
Pennsylvania American Water Co.	R-00922428	Pennsylvania Office of Consumer Advocate
Wheeling Power Co.	Case No. 90-243-E-42T	West Virginia Public Service Commission Consumer Advocate Division
Jersey Central Power & Light Co.	EM89110888	New Jersey Department of Public Advocate Division of Rate Counsel
Golden Shores Water Co.	U-1815-92-200	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-92-135	Residential Utility Consumer Office
Sulphur Springs Valley Electric Cooperative	U-1575-92-220	Residential Utility Consumer Office
North Mohave Valley Corporation	U-2259-92-318	Residential Utility Consumer Office
Graham County Electric Cooperative	U-1749-92-298	Residential Utility Consumer Office

Graham County Utilities	U-2527-92-303	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-93-110	Residential Utility Consumer Office
Litchfield Park Service Co.	U-1427-93-156 & U-1428-93-156	Residential Utility Consumer Office
Pima Utility Company	U-2199-93-221 & U-2199-93-222	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-94-306	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-182	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-310 & U-1303-94-401	Residential Utility Consumer Office
Pima Utility Company	U-2199-94-439	Residential Utility Consumer Office
SaddleBrooke Development Co.	U-2492-94-448	Residential Utility Consumer Office
Boulders Carefree Sewer Corp.	U-2361-95-007	Residential Utility Consumer Office
Rio Rico Utilities	U-2676-95-262	Residential Utility Consumer Office
Rancho Vistoso Water	U-2342-95-334	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-95-491	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-473	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-417 et al.	Residential Utility Consumer Office

Paradise Valley Water	U-1303-96-283 & U-1303-95-493	Residential Utility Consumer Office
Far West Water	U-2073-96-531	Residential Utility Consumer Office
Southwest Gas Corporation	U-1551-96-596	Residential Utility Consumer Office
Arizona Telephone Company	T-2063A-97-329	Residential Utility Consumer Office
Far West Water Rehearing	W-0273A-96-0531	Residential Utility Consumer Office
SaddleBrooke Utility Company	W-02849A-97-0383	Residential Utility Consumer Office
Vail Water Company	W-01651A-97-0539 & W-01651B-97-0676	Residential Utility Consumer Office
Black Mountain Gas Company Northern States Power Company	G-01970A-98-0017 G-03493A-98-0017	Residential Utility Consumer Office
Paradise Valley Water Company Mummy Mountain Water Company	W-01303A-98-0678 W-01342A-98-0678	Residential Utility Consumer Office
Bermuda Water Company	W-01812A-98-0390	Residential Utility Consumer Office
Bella Vista Water Company Nicksville Water Company	W-02465A-98-0458 W-01602A-98-0458	Residential Utility Consumer Office
Paradise Valley Water Company	W-01303A-98-0507	Residential Utility Consumer Office
Pima Utility Company	SW-02199A-98-0578	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144 Interim Rates	Residential Utility Consumer Office

Vail Water Company	W-01651B-99-0355 Interim Rates	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144	Residential Utility Consumer Office
Sun City Water and Sun City West	W-01656A-98-0577 & SW-02334A-98-0577	Residential Utility Consumer Office
Southwest Gas Corporation ONEOK, Inc.	G-01551A-99-0112 G-03713A-99-0112	Residential Utility Consumer Office
Table Top Telephone	T-02724A-99-0595	Residential Utility Consumer Office
U S West Communications Citizens Utilities Company	T-01051B-99-0737 T-01954B-99-0737	Residential Utility Consumer Office
Citizens Utilities Company	E-01032C-98-0474	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-00-0309 & G-01551A-00-0127	Residential Utility Consumer Office
Southwestern Telephone Company	T-01072B-00-0379	Residential Utility Consumer Office
Arizona Water Company	W-01445A-00-0962	Residential Utility Consumer Office
Litchfield Park Service Company	W-01427A-01-0487 & SW-01428A-01-0487	Residential Utility Consumer Office
Bella Vista Water Co., Inc.	W-02465A-01-0776	Residential Utility Consumer Office
Generic Proceedings Concerning Electric Restructuring Issues	E-00000A-02-0051	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-02-0707	Residential Utility Consumer Office
Qwest Corporation	RT-00000F-02-0271	Residential Utility Consumer Office

Arizona Public Service Company	E-01345A-02-0403	Residential Utility Consumer Office
Citizens/UniSource	G-01032A-02-0598 E-01032C-00-0751 E-01933A-02-0914 E-01302C-02-0914 G-01302C-02-0914	Residential Utility Consumer Office
Arizona-American Water Company	WS-01303A-02-0867	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-03-0437	Residential Utility Consumer Office
UniSource	E-04230A-03-0933	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-04-0407	Residential Utility Consumer Office
Qwest Corporation	T-01051B-03-0454 & T-00000D-00-0672	Residential Utility Consumer Office
Tucson Electric Power Company	E-01933A-04-0408	Residential Utility Consumer Office
Arizona-American Water Company	W-1303A-05-0280	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-04-0876	Residential Utility Consumer Office
Arizona-American Water Company	W-1303A-05-0405	Residential Utility Consumer Office